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No. 86-84

# In the Supreme Court

OF THE

# United States

OCTOBER TERM, 1985

NATIONAL BANCARD CORPORATION,

*Petitioner,*

VS.

VISA U.S.A. INC.,

*Respondent.*

## BRIEF OF VISA U.S.A. INC. IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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## QUESTION PRESENTED

Whether the District Court and Court of Appeals properly held that the rule of reason should be applied to a VISA rule setting an internal cost-allocating fee, when VISA is a joint venture that produces a product that no member alone could produce, and when rules in general, and this one in particular, are necessary to the efficient functioning of the VISA system.

## AFFILIATED CORPORATIONS

Pursuant to Supreme Court Rule 28, VISA U.S.A. Inc. states that it is a member of VISA International Service Association, and that tens of thousands of banks and other financial institutions worldwide are members of VISA U.S.A. and VISA International.

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### I.

National Bancard Corporation ("NaBanco") seeks certiorari on the hypothesis that the Eleventh Circuit's opinion in this case announced a new rule of antitrust law. But as even a quick review of the opinion reveals, the Court of Appeals engaged in a routine application of established authority to a complex set of facts and affirmed the findings of the District Court made after a lengthy trial. Thus, NaBanco's petition presents no important or novel issue requiring resolution by this Court, which has addressed similar issues in at least three cases since 1979.

The singular premise of NaBanco's petition is that since horizontal price fixing is illegal per se, evidence that a practice enhances efficiency, or even that it is necessary to the operation of

a joint venture is irrelevant. Yet as this Court pointed out in *Broadcast Music, Inc. v. Columbia Broadcasting System*, 441 U.S. 1 (1979) ("*BMI*"), and reiterated in *National College Athletic Ass'n v. Board of Regents*, 468 U.S. 85 (1984) ("*NCAA*"), the label "horizontal price fixing" is a legal *conclusion* (albeit one that carries with it the consequence of per se illegality under Section 1 of the Sherman Act). That label is not applied mechanistically to any practice capable of being so characterized. To the contrary, application of the label "price fixing," with its attendant consequences,

> is not a question simply of determining whether two or more potential competitors have literally 'fixed' a 'price.' As generally used in the antitrust field, 'price fixing' is a shorthand way of describing certain categories of business behavior to which the *per se* rule has been held applicable. [A] literal approach does not alone establish that [a] particular practice is one of those types or that it is 'plainly anticompetitive' and very likely without 'redeeming virtue' .... Thus, it is necessary to characterize the challenged conduct as falling within or without that category of behavior to which we apply the label '*per se* price fixing.'

*BMI*, 441 U.S. at 9.

What follows, as both the District Court and the Court of Appeals properly recognized, is that the ultimate inquiry under either the per se rule or the rule of reason is the same:

> [W]hether the ultimate finding is the product of a presumption or actual market analysis, the essential inquiry remains the same—whether or not the challenged restraint enhances competition.

*NCAA*, 468 U.S. at 104. Considerations of efficiency and necessity plainly are germane to that inquiry.

NaBanco ignores these observations. It offers, instead, a pastiche of quotations wrenched from context and unhinged from any coherent theory of antitrust jurisprudence. It does so in an effort to demonstrate that *BMI* is a bastard-child of the antitrust laws,

which has been all but repudiated by subsequent cases.[1] The consequence, per NaBanco, is that this Court may, indeed must, ignore the detailed findings of the Courts below—findings that NaBanco is wholly incapable of contesting as a matter of fact—that the establishment of rules governing the interchange of "paper" among VISA system members (including the rule establishing a "fee") is not merely procompetitive, but necessary, to the existence and operation of the successful VISA system.

VISA submits that, despite NaBanco's procrustean efforts to demonstrate the contrary, this Court's decisions in *BMI, Maricopa* and *NCAA*[2] reflect a coherent and well-articulated body of antitrust law that requires neither restatement or refinement. VISA submits, further, that this conclusion is admirably evidenced by the decisions of the lower courts in this very case. Far from creating any novel rule of law, the decisions below simply state convincingly why the VISA interchange reimbursement fee ("IRF") is manifestly procompetitive in operation. That being the case, it would be a strange and unwise rule of law that would proscribe it per se and thereby threaten the very existence of the VISA system[3] in the name of furthering federal competition policy.

## II.

The antitrust laws have long recognized that effective competition is furthered when competitors are permitted to combine their efforts to produce a product or service that they could not produce at all, or as well, individually. *See, e.g., BMI*, 441 U.S. at 23. Furthermore, where a particular rule or practice of such a venture is essential to its existence or efficient operation, the rule is not unlawful, and certainly may not be proscribed by the mindless application of per se rules. Those general principles, in essence,

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[1] *Catalano, Inc. v. Target Sales, Inc.*, 446 U.S. 643 (1980); *Arizona v. Maricopa County Medical Society*, 457 U.S. 332 (1982); and *NCAA*, 468 U.S. 85.

[2] As to *Catalano, see infra* note 17.

[3] As the lower courts found, *see* A-88-90, A-193-194.

describe VISA and the IRF, and explain why the decisions below were, under settled principles, correct.

VISA is a for-profit, membership corporation comprised of more than thirteen thousand financial institutions throughout the United States.[4] The member banks issue cards, contract with merchants to accept the cards as payment for goods or services, or both, as they choose.[5] Together, VISA's members produce a product—the VISA payment service—that none alone could produce; the VISA card is currently accepted worldwide at hundreds of thousands of locations. To produce this service, VISA's members have integrated only to the extent necessary, leaving themselves otherwise free to compete within the VISA system for cardholder and merchant business, and outside the system, in every other area of their operations.[6]

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[4] VISA began as the BankAmericard, produced by the Bank of America. As the trial court found, even Bank of America—one of the largest banks in the country—was too small to operate the system on a large scale. Thus, at a very early date Bank of America began to license the card to other banks. VISA was ultimately formed as a separate joint venture in 1970.

[5] NaBanco's petition is, thus, fundamentally misleading to the extent it suggests that the VISA system is made up of two contending groups, card issuers and merchant-signers, or that IRF is something imposed by one group upon the other. To the contrary, as both lower courts found, VISA members are free to, and generally do, play both roles. The vast majority of VISA's largest members—which account for a very substantial portion of the system's total volume—are actively involved in both issuing cards and contracting with merchants to accept them. Thus, the convenient shorthand, "card issuing" and "merchant" bank, is merely descriptive of a given bank's role in a particular transaction only. From this fact follows an important point: IRF is established by members actively involved on both sides of the business (indeed when the fee was set at its highest level, the VISA Board was dominated by "net" merchant-signing banks).

[6] Joint ventures allow two or more firms to engage in some activity they could not as efficiently perform on their own. The legality of the enterprise is not a function of any particular degree of integration, or any particular configuration. In fact, contrary to NaBanco's suggestion,

Because there are so many VISA members, there generally will be two different banks involved in any given VISA transaction: the bank that issued the card, and the bank that contracted with the merchant to accept it. What necessarily follows from that fact is that there must be a mechanism to provide for the transfer between the two VISA members of the "paper" resulting from the transaction so that the merchant can be paid and the cardholder billed. This process is called "interchange." It is a feature of all multi-party payment systems, including checks,[7] credit cards, automated teller machine ("ATM") transactions, and inter-airline ticketing.

Interchange within VISA, as in other systems, is necessarily governed by rules. At issue in this case is one of these rules: the rule establishing the amount, or fee, that VISA regulations

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Petition at 4, partial integration will generally be more competitive than complete integration, precisely because it leaves the participants free to compete against each other to the maximum extent in nonintegrated activities. *See* Louis, *Restraints Ancillary to Joint Ventures and Licensing Agreements; Do Sealy and Topco Logically Survive Sylvania and Broadcast Music*? 66 Va. L. Rev. 879, 896 n.114 (1980).

[7] Checks, in fact, provide the most common example of interchange. Interchange of checks has been taking place for almost two hundred years, and today occurs pursuant to rules established by the Federal Reserve. One of these rules mandates the interchange of checks at par. The fact that check clearance occurs at par rather than at some other amount (as in VISA, MasterCard, ATMs, etc.) reflects the different economics of the checking system. For example, in the VISA system the card-issuing bank effectively insures both the merchant and the merchant-signing bank against fraud losses, a marked contrast to the rules governing checks. Similarly, one of the historic benefits of open-book retail credit systems (*e.g.*, a Macy's charge account), and a feature also of the VISA system, is the availability of some "free" period in which the customer can pay off his balance in full without incurring any finance charge. The "float" cost of that free period is obviously substantial and is borne by the card-issuing bank. For a detailed discussion of the history of checking interchange, as well as of the economics of four-party payment mechanisms, see Baxter, *Bank Interchange of Transactional Paper: Legal and Economic Perspectives*, 26 J.L. & Econ. 541 (1983).

require the merchant-signing bank to "pay" the card-issuing bank on all VISA transactions that are interchanged through VISA's computer system, known as BASE II.[8] That fee is referred to as the "interchange reimbursement fee" or, simply, "IRF".[9]

IRF serves two principal functions, both of which are essential to the existence and competitive vigor of VISA. First, like the many other rules governing interchange, IRF establishes the certainty of obligation without which the system could not function.[10] Second, IRF is a cost-sharing device designed to right the imbalance of costs and revenues between the merchant and issuing sides of what is, inherently, an interdependent business, thereby enabling the competitively optimal number of VISA transactions to occur. Both functions—ignored by NaBanco—warrant brief explication.

As noted above, interchange cannot take place without rules governing its fundamental terms. IRF is simply one of those rules. The necessity for rules arises from the fact that VISA sales drafts (known colloquially as "paper") are not marketable commercial instruments: only one bank—the card-issuing bank—has any interest in purchasing the paper from the merchant bank because

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[8] Thus, IRF does not much resemble a price: IRF is to VISA as a whole a net "zero," *i.e.*, every IRF dollar received by one member is paid by another; and, IRF is not charged to third parties outside the venture, but is merely an internal mechanism for allocating costs.

[9] Use of the computer system is optional, and paper interchanged by other means is not subject to IRF. Thus, as both the District Court and Court of Appeals found significant, payment of IRF is optional. If paper is interchanged outside of the VISA BASE II system the parties are permitted to establish alternative interchange rules.

[10] To ensure the appeal of the card and to encourage its use, VISA rules require participating merchants (through their respective merchant banks) to accept all validly tendered VISA cards regardless of which bank issued the card, and require the issuing bank to purchase from the merchant bank all sales drafts resulting from one of its cardholders' use of a VISA card. Because of this obligation of "universality," member banks must know in advance what their costs will be. Hence the need for rules.

only it is contractually entitled, or practically able, to bill its cardholder. Without advance agreement on the terms of the "sale," however, the issuing bank could drive whatever bargain it wished.[11] IRF supplies the requisite certainty, by placing a ceiling on the "price" the issuing bank may demand when purchasing paper in interchange.[12]

The second function of IRF is fulfilled by the level at which it is set. IRF operates as a mechanism to allocate the costs of producing the interdependent VISA service and, in that sense, is not a "price" at all. Reallocation of the costs of producing the service is essential because of the interdependence of the VISA system: each cardholder's use of the card must be matched with a merchant's acceptance of it as payment. As a practical and legal matter, banks are able to earn substantial revenues from merchant-side business, where there is little risk and few costs, but little revenue from the issuer side, which bears substantial risk and virtually all the costs.

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[11] In economic terms, this is a classic example of opportunistic behavior by a monopsonistic buyer. The problem arises because of the absence of a competitive market, which causes individually beneficial self-interested behavior to become harmful or potentially destructive to the system as a whole. "Opportunism" and the "free rider" problem have recently come to be recognized as central concepts in economics and, even more recently, in antitrust jurisprudence. *See, e.g.*, O. Williamson, *Markets and Hierarchies* (1975); *Continental T.V., Inc. v. G.T.E. Sylvania, Inc.*, 433 U.S. 36 (1977).

[12] That issuers would take advantage of the system by acting in their own self-interest is not mere speculation, but is based on historical experience. VISA began as a licensing operation of the Bank of America in the late 1950s. Bank of America did not set a fee to compensate the issuer banks for the costs they bore, but required the merchant banks to pay the issuers either the actual or average amounts they received from their merchants. In practice, the merchant banks took advantage of the system in a variety of ways. Unable to earn sufficient revenues to cover their costs, a number of issuing banks threatened to leave the system. As a result, the system was reorganized as a joint venture with a fixed interchange fee. See also Baxter, 26 J.L. & Econ. 541, for an account of similar experiences with check clearance.

As in any other business, the quantity of transactions "supplied" by either side is a function of the costs of producing the service. However, these costs too are interdependent; many of the expenses borne by the card-issuing side demonstrably benefit the merchant side of the business. For example, VISA rules require the card-issuing bank to bear the costs of fraud and float. That benefits the merchant "side" of the business by facilitating and encouraging use of the card.[13]

Because each cardholder's use of the card must be matched by a merchant's willingness to accept the card as payment, and vice versa, the system would not function if the costs of supplying transactions could not be covered by revenues earned. By allocating the costs of the venture with respect to the benefits received, IRF produces an optimal number of VISA transactions, and thus enhances the overall efficiency of this unavoidably interdependent system. Stated in antitrust terminology, IRF is, therefore, output enhancing rather than output restrictive.

Both courts below held that IRF serves these procompetitive purposes. Equally important, they also found that there is no practical alternative to a set fee. It would be both prohibitively expensive and logistically impossible for each card-issuing bank to negotiate with each merchant bank over the "price" at which it would agree to interchange paper. Alternatively, if issuing banks simply announced the price they would charge, many would behave opportunistically, *i.e.*, take advantage of the system by charging too high a fee. Ultimately, merchant banks would either leave the VISA system, switch to card-issuing only, or refuse to pay the excessive fees, thus undermining universality and the attractiveness of the VISA card.

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[13] The methodology for setting IRF was designed by the independent accounting firm Arthur Andersen after studying the costs of the business. The level of IRF is periodically re-evaluated following similar cost studies.

## III.

What we have just described was the subject of a nine-week bench trial. At its conclusion, the District Court held that the per se rule against price fixing was not applicable in this case, and that under the rule of reason establishment of IRF was manifestly procompetitive. The Court of Appeals affirmed.

NaBanco's petition does not seriously contest the finding that there is no alternative to a fixed fee,[14] and simply ignores the lower courts' findings on the procompetitive benefits of IRF. Rather, NaBanco proceeds from the simple-minded premise that because VISA is a cooperative effort, it may not set IRF. However, the only way in which that argument makes sense is if both the holding and the logic of *BMI* and *NCAA* are ignored or rejected. What is more, to do so would have the practical effect not only of eviscerating the VISA joint venture, but of casting doubt upon the legality of joint enterprises under the antitrust laws.

In *BMI*, 441 U.S. 1, this Court held that a practice that on its face technically involved "price fixing" did not constitute a per se violation because of its obvious procompetitive or efficiency-enhancing potential. *BMI* involved a challenge to BMI's and ASCAP's practice of selling for a fixed fee a blanket license to use any of the musical compositions in their libraries. The central issue before the Court was whether that practice, involving, as it literally did, an agreement as to price between horizontal competitors, was illegal per se without regard to considerations of efficiency or necessity. The Court held that it was not. Rather, the

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[14] Instead, it weakly offers the suggestion that VISA could mandate interchange at par. But, a price fixed at zero is still a fixed price. NaBanco glosses over this by arguing that in the absence of agreement, the issuing bank would have a "legal obligation" to purchase its cardholder's paper at par. Of course, this makes no sense since the legal obligation arises precisely, and only, from the agreements that establish VISA. Moreover, while checks interchange at par, the economics of the checking system are wholly different from those of VISA. *See supra* note 7.

Court held that in evaluating the potential application of the per se rule it is necessary to determine whether a challenged practice

> facially appears to be one that would always or almost always tend to restrict competition and decrease output, and in what portion of the market, or instead [is] designed to 'increase economic efficiency' and render markets more, rather than less, competitive.

*Id.* at 19-20.

Applying this standard, the Court held that the blanket license in question was not a naked restraint of trade, but a device that enabled the realization of a variety of efficiencies—one that created a "whole . . . truly greater than the sum of its parts . . . to some extent, a different product."[15] Moreover, the Court observed that "joint ventures and other cooperative arrangements are not usually unlawful, at least not as price-fixing schemes, where the agreement on price is necessary to market the product at all." *Id.* at 23.[16]

NaBanco's petition argues that *BMI* is an isolated and limited exception to the strict per se rule, and that this fact is shown by the subsequent decisions in *Catalano, Maricopa,* and *NCAA.* However, its argument does a serious injustice to those cases and

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[15] NaBanco argues that the VISA card is the product of each individual member and not a product of the venture as a whole. This totally ignores the significance of "universality," without which the system would not be a system. While many banks could produce a credit card, no bank alone could produce a card with the scope of the VISA card, because no bank is big enough to assume a risk of that magnitude. Together, VISA members have created a product that none alone could produce.

[16] Realizing that *BMI* is strong authority against it, NaBanco feels compelled to misrepresent one of its central points. NaBanco claims that the blanket license was validated because the Court viewed individual licenses as a "realistic alternative" to the blanket license offered by BMI. This, they claim, distinguishes BMI from VISA, where there is no real alternative to IRF. However, the Court found the blanket license an efficiency-producing integration precisely *because* individual licenses were not a competitively realistic alternative. 441 U.S. at 20-24.

the coherent scheme of antitrust law that they embrace. For example, in *Arizona v. Maricopa County Medical Society*, 457 U.S. 332 (1982), this Court applied the *BMI* analysis but, on the facts of that case, reached the opposite conclusion. *Maricopa* involved a challenge to an insurance plan established by a group of doctors. The Court properly held the per se rule applicable because the organization did not permit the doctors to sell a product they could not offer separately, and because the doctors offered no reason to support their claim that *they* had to fix the price at which they would collectively sell their services.

NaBanco also would have this Court believe that *NCAA* did not follow *BMI*, when that is precisely what it did. In that case the Court held the NCAA's plan for televising college football games illegal *under the rule of reason*. Despite the fact that the plan involved both an output limitation and a horizontal price agreement, the Court declined to apply the per se rule because the "case involve[d] an industry in which horizontal restraints on competition are essential if the product is to be available at all." *Id.* at 101. The fact that the Court found the NCAA's television plan illegal under the rule of reason does not change the fact that it refused to apply the per se rule for the very reasons articulated in *BMI*.[17]

This case is closer to *BMI* and *NCAA* than to *Maricopa* (let alone *Catalano*). NaBanco's arguments to the contrary ignore the facts as found by the courts below as well as the fair intendment of this Court's recent decisions.[18] Thus, NaBanco persists in

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[17] We are mystified by NaBanco's reliance on *Catalano*, 446 U.S. 643. *Catalano* was a classic price fixing case, involving an agreement among wholesalers to eliminate the extension of credit to retail customers. The procompetitive justifications alleged there are the same justifications rejected for years in per se price fixing cases. The only issue in the case had to do with whether the per se rule applied to a "component" of price as opposed to the price of the product itself. The case has nothing to do with joint enterprise or the kind of analysis implicated by *BMI*, *NCAA*, or *Maricopa*.

[18] The Court has been steadily moving away from application of per se rules to restraints that may accompany efficiency-producing practices.

arguing that the VISA card is a product of the individual member banks and not of the venture as a whole, despite the findings of the courts below that the VISA payment service could not be offered by any individual bank. And it would have the Court view IRF as a device designed by issuers alone to line their pockets, when the VISA Board of Directors, which establishes the fee, includes banks that do a substantial amount of merchant-side business and when the level of the fee is set after consultation with and study by an independent accounting firm.

In sum, the Eleventh Circuit has done no more than apply this Court's decisions in accordance with their well-articulated rationales. NaBanco selects a few isolated passages from its opinion and quotes them out of context in an attempt to show that the decision creates a "new test": "whether [the price fixing] '*potentially* could create an *efficiency enhancing integration* to which the restraint is ancillary.' " Petition at 11 (quoting A-182) (emphasis supplied by NaBanco). It thus suggests that simply by alleging "potential efficiencies" an antitrust defendant can escape per se treatment. But NaBanco misreads, or misrepresents, the Court's opinion. The Court of Appeals was not identifying what a defendant must allege to escape the per se rule, but was correctly explaining the nature of the inquiry that *BMI* requires.[19]

Read in full, the opinion below amply demonstrates that the Court of Appeals both understood and correctly applied the standards enunciated previously by this Court. It held that "VISA exhibits characteristics of a joint venture, even if it is not technically a joint venture," A-192, and that the VISA joint venture had developed a product " 'truly greater than the sum of its parts,' " A-193 (quoting *BMI*, 441 U.S. at 21-22). It went on

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*See, e.g., Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977) (vertical market division); *Jefferson Parish Hospital District No. 2 v. Hyde*, 466 U.S. 2 (1984) (tie-ins); *Northern Wholesale Stationers, Inc. v. Pacific Stationery & Printing Co.*, 105 S. Ct. 2613 (1985) (horizontal boycott).

[19] The full sentence reads: "*BMI's* underlying teaching therefore appears to be that courts should look to whether the restraint at issue potentially could create a efficiency enhancing integration."

to hold that interchange rules—of which IRF is only one—are " 'a *necessary consequence* of the integration necessary to achieve these efficiencies [the universality of the VISA credit card].' " A-194 (emphasis added) (quoting *BMI*, 441 U.S. at 21; *see also NCAA*, 468 U.S. at 101-102). The Court of Appeals also held, as did the District Court, that IRF creates efficiencies by functioning as a cost-sharing mechanism: "It is an internal accounting procedure between joint venturers that shifts a portion of the revenues from the merchant-signing parties to the card-issuing parties," A-197, thus allowing the optimal level of VISA transactions.

In summing up its analysis, the Court of Appeals stated that

> in deciding whether a challenged practice is subject to rule of reason or per se analysis, the court must inquire into whether the practice, on its face, always or almost always tends to restrict output or instead is likely to assist the creation of economic efficiency . . . . Rigid line-drawing must be avoided and close attention given to procompetitive, efficiency-creating integration that is accomplished as the result of an anticompetitive, yet ancillary, restraint.

A-198. That is precisely the inquiry mandated by this Court's recent opinions. It is also an inquiry that leads, inexorably, to the conclusion that the VISA IRF is procompetitive. Thus, no further review is necessary to affirm the correctness of the approach taken by the courts below or the decision reached by them.

## IV.

For the foregoing reasons, NaBanco's petition for a writ of certiorari should be denied.

Dated: September 29, 1986

Respectfully submitted,

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